# Budget Deficits, Social Security, and Younger Generations

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Thank you for inviting me to discuss the effect of budget deficits on young adults. Debates over the federal budget may seem quite removed from the hectic lives of adults below the age of 35, who are struggling to finish school, decide upon a career and find a job, and in some cases to start a family.

The reality, though, is that policy-makers in Washington are making decisions with substantial implications for these young adults, for it is disproportionately younger generations who will inherit the consequences of our fiscal policies. In other words, we have become used to thinking about how environmental policy leaves a legacy for younger generations. But fiscal policy also leaves a legacy. And on our current fiscal path, policy-makers are simply not doing right by today's young adults.

Young adults deserve a better future than the one implied by today's national saving rate of less than two percent of national income, which is the lowest since 1934. That low saving rate, which reflects our elevated budget deficit, necessarily carries one of two possible implications: Either we reduce the amount we invest at home to two percent of income, which would starve young Americans of the computers, buildings, and other productive capital they will need to enjoy better standards of living in the future. Or if we do invest more than two percent of our income, we must borrow the difference from foreigners – which would leave younger generations increasingly indebted to other nations. Either way, today's young Americans are the ones who will pay the price for our current unwillingness to pay our way.

[1] The views expressed are those of mine alone and should not be attributed to the trustees, officers, or staff of the Brookings Institution or the Tax Policy Center.

Let me illustrate the point. Under reasonable projections, the budget deficit over the next decade will amount to about $5 trillion. Compared to a balanced budget, these deficits will reduce national income in 2015 by $2,000 or more annually per household, on average.

Budget deficits have another adverse effect on younger Americans, who disproportionately tend to be in debt. Data from the Survey of Consumer Finances suggest that almost a fifth of households headed by young adults have negative net worth – for example, because their student loan and credit card debts exceed their assets. Standard estimates suggest that the budget deficits projected over the next decade will raise interest rates by about one percentage point, which will impose additional costs on young households in debt.

**The 2001 and 2003 tax cuts**

A key factor in this inauspicious budget outlook is the effect of extending the 2001 and 2003 tax cuts. Young adults should be demanding that policy-makers explain precisely how the tax cuts will be financed, since continuing to borrow to pay for them will just shift the costs to the future -- when today's young adults will bear a significant share of the burden. The less older generations pay toward the government's bills, the more younger generations will have to pay, and vice versa.

The choices for financing the tax cuts are not attractive – which is perhaps why no one has put forward a credible proposal to do so. For example, just to finance the revenue losses in 2014 – and not even cover the interest costs on the tax cuts before then – requires an 11 percent cut in all non-interest spending; a 49 percent cut in all spending other than interest, defense, homeland security, Social Security, Medicare and Medicaid; or an 80 percent cut in all domestic discretionary spending, such as for environmental protection, education, and homeland security.

If we're not willing to pay for the tax cuts through the types of changes I just described, we shouldn't keep charging them to the nation's credit card and leaving young Americans with the bill.

**Social Security**

I'd like to close with a short discussion of Social Security. Social Security faces a long-term deficit. Restoring long-term financial balance to Social Security is therefore necessary, but it is not necessary to destroy the program in order to save it – especially since the Social Security deficit is not the primary explanation for the nation's long-term budget imbalance. The tax cuts and particularly the projected increases in Medicare and Medicaid are much more important factors.

I would emphasize two key aspects of the Social Security debate to younger Americans. First, despite the misleading claims of some Washington charlatans, there are no free lunches -- someone has to pay. So younger Americans should be asking how we should finance the necessary changes across different generations, and across different people within generations.

These questions are particularly important because many of the Social Security reforms that are advanced as benefiting today's young Americans would actually impose the greatest costs on them. For example, replacing the current Social Security system with a fully-funded individual account program requires someone to pay. One possible financing scheme is to cut off our parents and grandparents from the benefits they are already receiving or are planning to receive in the near future, but that seems neither likely nor desirable. The most plausible alternative, at least within an honestly funded plan, would require today's young workers to pay twice: Once to make sure that their parents and grandparents are protected, and again to build up their own retirement funds.

In other words, it is precisely today's young workers who would bear the brunt of the so-called transition costs in moving to an individual account system. Such proposals are often misleadingly presented as benefiting today's young workers, whereas in reality they would impose substantial additional costs on today's young workers in exchange for generating significant benefits to far-distant generations. A recent reform plan that Professor Peter Diamond and I have put forward is aimed at a more even distribution of the necessary costs across different generations in the future while also eliminating the projected deficit in Social Security.

A second point is equally important. The image of Social Security solely as a retirement program is inaccurate: The program provides a key layer of financial security during other particular times of need, such as disability or the death of a family member, and about one-seventh of beneficiaries are younger than 62. Social Security thus provides not only benefits to our parents and grandparents, but also insurance to today's younger workers. This is valuable, since today's 20-year-olds have more than a one-in-five probability of receiving disability benefits before age 67. And the benefits that are paid out from Social Security are protected against inflation and the risk of stock market collapses. Many individual account reform proposals reduce disability and young survivor benefits. Individual accounts do little to offset such reductions, since workers becoming disabled or dying young have typically not had time to build up their accounts -- and some proposals do not give disabled workers access to whatever modest balances they have accumulated in the accounts. Especially as the private retirement system on top of Social Security shifts from a defined benefit to a defined contribution one, it makes little sense to engineer a shift to individual accounts within the core layer of financial security provided by Social Security.

Thank you once again for inviting me to testify this afternoon, and I look forward to your questions.